

## SENATE BILL No. 608

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### DIGEST OF INTRODUCED BILL

**Citations Affected:** IC 6-3; IC 6-8.1-5-1.

**Synopsis:** Expense disallowance. Requires a corporation, for purposes of computing state adjusted gross income tax, to add back deductions taken on the corporation's federal income tax return for certain interest and intangible expenses incurred in a transaction with a related business.

**Effective:** January 1, 2005 (retroactive).

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### Weatherwax, Simpson

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January 24, 2005, read first time and referred to Committee on Tax and Fiscal Policy.

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Introduced

First Regular Session 114th General Assembly (2005)

PRINTING CODE. Amendments: Whenever an existing statute (or a section of the Indiana Constitution) is being amended, the text of the existing provision will appear in this style type, additions will appear in **this style type**, and deletions will appear in ~~this style type~~.

Additions: Whenever a new statutory provision is being enacted (or a new constitutional provision adopted), the text of the new provision will appear in **this style type**. Also, the word **NEW** will appear in that style type in the introductory clause of each SECTION that adds a new provision to the Indiana Code or the Indiana Constitution.

Conflict reconciliation: Text in a statute in *this style type* or ~~this style type~~ reconciles conflicts between statutes enacted by the 2004 Regular Session of the General Assembly.

## SENATE BILL No. 608

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A BILL FOR AN ACT to amend the Indiana Code concerning taxation.

*Be it enacted by the General Assembly of the State of Indiana:*

- 1       SECTION 1. IC 6-3-1-3.5 IS AMENDED TO READ AS  
2       FOLLOWS [EFFECTIVE JANUARY 1, 2005 (RETROACTIVE)]:  
3       Sec. 3.5. When used in this article, the term "adjusted gross income"  
4       shall mean the following:  
5       (a) In the case of all individuals, "adjusted gross income" (as  
6       defined in Section 62 of the Internal Revenue Code), modified as  
7       follows:  
8       (1) Subtract income that is exempt from taxation under this article  
9       by the Constitution and statutes of the United States.  
10      (2) Add an amount equal to any deduction or deductions allowed  
11      or allowable pursuant to Section 62 of the Internal Revenue Code  
12      for taxes based on or measured by income and levied at the state  
13      level by any state of the United States.  
14      (3) Subtract one thousand dollars (\$1,000), or in the case of a  
15      joint return filed by a husband and wife, subtract for each spouse  
16      one thousand dollars (\$1,000).  
17      (4) Subtract one thousand dollars (\$1,000) for:

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- 1 (A) each of the exemptions provided by Section 151(c) of the
- 2 Internal Revenue Code;
- 3 (B) each additional amount allowable under Section 63(f) of
- 4 the Internal Revenue Code; and
- 5 (C) the spouse of the taxpayer if a separate return is made by
- 6 the taxpayer and if the spouse, for the calendar year in which
- 7 the taxable year of the taxpayer begins, has no gross income
- 8 and is not the dependent of another taxpayer.
- 9 (5) Subtract:
- 10 (A) one thousand five hundred dollars (\$1,500) for each of the
- 11 exemptions allowed under Section 151(c)(1)(B) of the Internal
- 12 Revenue Code for taxable years beginning after December 31,
- 13 1996; and
- 14 (B) five hundred dollars (\$500) for each additional amount
- 15 allowable under Section 63(f)(1) of the Internal Revenue Code
- 16 if the adjusted gross income of the taxpayer, or the taxpayer
- 17 and the taxpayer's spouse in the case of a joint return, is less
- 18 than forty thousand dollars (\$40,000).
- 19 This amount is in addition to the amount subtracted under
- 20 subdivision (4).
- 21 (6) Subtract an amount equal to the lesser of:
- 22 (A) that part of the individual's adjusted gross income (as
- 23 defined in Section 62 of the Internal Revenue Code) for that
- 24 taxable year that is subject to a tax that is imposed by a
- 25 political subdivision of another state and that is imposed on or
- 26 measured by income; or
- 27 (B) two thousand dollars (\$2,000).
- 28 (7) Add an amount equal to the total capital gain portion of a
- 29 lump sum distribution (as defined in Section 402(e)(4)(D) of the
- 30 Internal Revenue Code) if the lump sum distribution is received
- 31 by the individual during the taxable year and if the capital gain
- 32 portion of the distribution is taxed in the manner provided in
- 33 Section 402 of the Internal Revenue Code.
- 34 (8) Subtract any amounts included in federal adjusted gross
- 35 income under Section 111 of the Internal Revenue Code as a
- 36 recovery of items previously deducted as an itemized deduction
- 37 from adjusted gross income.
- 38 (9) Subtract any amounts included in federal adjusted gross
- 39 income under the Internal Revenue Code which amounts were
- 40 received by the individual as supplemental railroad retirement
- 41 annuities under 45 U.S.C. 231 and which are not deductible under
- 42 subdivision (1).

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(10) Add an amount equal to the deduction allowed under Section 221 of the Internal Revenue Code for married couples filing joint returns if the taxable year began before January 1, 1987.

(11) Add an amount equal to the interest excluded from federal gross income by the individual for the taxable year under Section 128 of the Internal Revenue Code if the taxable year began before January 1, 1985.

(12) Subtract an amount equal to the amount of federal Social Security and Railroad Retirement benefits included in a taxpayer's federal gross income by Section 86 of the Internal Revenue Code.

(13) In the case of a nonresident taxpayer or a resident taxpayer residing in Indiana for a period of less than the taxpayer's entire taxable year, the total amount of the deductions allowed pursuant to subdivisions (3), (4), (5), and (6) shall be reduced to an amount which bears the same ratio to the total as the taxpayer's income taxable in Indiana bears to the taxpayer's total income.

(14) In the case of an individual who is a recipient of assistance under IC 12-10-6-1, IC 12-10-6-2.1, IC 12-15-2-2, or IC 12-15-7, subtract an amount equal to that portion of the individual's adjusted gross income with respect to which the individual is not allowed under federal law to retain an amount to pay state and local income taxes.

(15) In the case of an eligible individual, subtract the amount of a Holocaust victim's settlement payment included in the individual's federal adjusted gross income.

(16) For taxable years beginning after December 31, 1999, subtract an amount equal to the portion of any premiums paid during the taxable year by the taxpayer for a qualified long term care policy (as defined in IC 12-15-39.6-5) for the taxpayer or the taxpayer's spouse, or both.

(17) Subtract an amount equal to the lesser of:

(A) for a taxable year:

(i) including any part of 2004, the amount determined under subsection (f); and

(ii) beginning after December 31, 2004, two thousand five hundred dollars (\$2,500); or

(B) the amount of property taxes that are paid during the taxable year in Indiana by the individual on the individual's principal place of residence.

(18) Subtract an amount equal to the amount of a September 11 terrorist attack settlement payment included in the individual's federal adjusted gross income.

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(19) Add or subtract the amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k)(2)(C)(iii) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.

(20) Add an amount equal to any deduction allowed under Section 172 of the Internal Revenue Code.

(b) In the case of corporations, the same as "taxable income" (as defined in Section 63 of the Internal Revenue Code) adjusted as follows:

(1) Subtract income that is exempt from taxation under this article by the Constitution and statutes of the United States.

(2) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 170 of the Internal Revenue Code.

(3) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States.

(4) Subtract an amount equal to the amount included in the corporation's taxable income under Section 78 of the Internal Revenue Code.

(5) Add or subtract the amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k)(2)(C)(iii) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.

(6) Add an amount equal to any deduction allowed under Section 172 of the Internal Revenue Code.

**(7) Add or subtract the amount determined under IC 6-3-2-20.**

(c) In the case of life insurance companies (as defined in Section 816(a) of the Internal Revenue Code) that are organized under Indiana law, the same as "life insurance company taxable income" (as defined in Section 801 of the Internal Revenue Code), adjusted as follows:

(1) Subtract income that is exempt from taxation under this article

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by the Constitution and statutes of the United States.

(2) Add an amount equal to any deduction allowed or allowable under Section 170 of the Internal Revenue Code.

(3) Add an amount equal to a deduction allowed or allowable under Section 805 or Section 831(c) of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state.

(4) Subtract an amount equal to the amount included in the company's taxable income under Section 78 of the Internal Revenue Code.

(5) Add or subtract the amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k)(2)(C)(iii) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.

(6) Add an amount equal to any deduction allowed under Section 172 or Section 810 of the Internal Revenue Code.

**(7) Add or subtract the amount determined under IC 6-3-2-20.**

(d) In the case of insurance companies subject to tax under Section 831 of the Internal Revenue Code and organized under Indiana law, the same as "taxable income" (as defined in Section 832 of the Internal Revenue Code), adjusted as follows:

(1) Subtract income that is exempt from taxation under this article by the Constitution and statutes of the United States.

(2) Add an amount equal to any deduction allowed or allowable under Section 170 of the Internal Revenue Code.

(3) Add an amount equal to a deduction allowed or allowable under Section 805 or Section 831(c) of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state.

(4) Subtract an amount equal to the amount included in the company's taxable income under Section 78 of the Internal Revenue Code.

(5) Add or subtract the amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made

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under Section 168(k)(2)(C)(iii) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.

(6) Add an amount equal to any deduction allowed under Section 172 of the Internal Revenue Code.

**(7) Add or subtract the amount determined under IC 6-3-2-20.**

(e) In the case of trusts and estates, "taxable income" (as defined for trusts and estates in Section 641(b) of the Internal Revenue Code) adjusted as follows:

(1) Subtract income that is exempt from taxation under this article by the Constitution and statutes of the United States.

(2) Subtract an amount equal to the amount of a September 11 terrorist attack settlement payment included in the federal adjusted gross income of the estate of a victim of the September 11 terrorist attack or a trust to the extent the trust benefits a victim of the September 11 terrorist attack.

(3) Add or subtract the amount necessary to make the adjusted gross income of any taxpayer that owns property for which bonus depreciation was allowed in the current taxable year or in an earlier taxable year equal to the amount of adjusted gross income that would have been computed had an election not been made under Section 168(k)(2)(C)(iii) of the Internal Revenue Code to apply bonus depreciation to the property in the year that it was placed in service.

(4) Add an amount equal to any deduction allowed under Section 172 of the Internal Revenue Code.

(f) This subsection applies only to the extent that an individual paid property taxes in 2004 that were imposed for the March 1, 2002, assessment date or the January 15, 2003, assessment date. The maximum amount of the deduction under subsection (a)(17) is equal to the amount determined under STEP FIVE of the following formula:

STEP ONE: Determine the amount of property taxes that the taxpayer paid after December 31, 2003, in the taxable year for property taxes imposed for the March 1, 2002, assessment date and the January 15, 2003, assessment date.

STEP TWO: Determine the amount of property taxes that the taxpayer paid in the taxable year for the March 1, 2003, assessment date and the January 15, 2004, assessment date.

STEP THREE: Determine the result of the STEP ONE amount divided by the STEP TWO amount.

STEP FOUR: Multiply the STEP THREE amount by two

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thousand five hundred dollars (\$2,500).

STEP FIVE: Determine the sum of the STEP ~~THREE~~ FOUR amount and two thousand five hundred dollars (\$2,500).

SECTION 2. IC 6-3-2-20 IS ADDED TO THE INDIANA CODE AS A NEW SECTION TO READ AS FOLLOWS [EFFECTIVE JANUARY 1, 2005 (RETROACTIVE)]: **Sec. 20. (a) The following definitions apply throughout this section:**

(1) "Intangible expenses and costs" includes the following, to the extent that the amounts are allowed as deductions or costs in determining federal taxable income before operating loss deductions and special deductions for the taxable year under the Internal Revenue Code:

(A) Expenses, losses, and costs for, related to, or in connection directly or indirectly with the direct or indirect use, maintenance, or management of intangible property.

(B) Royalty or licensing fees related to the use of intangible property.

(C) Other similar expenses and costs.

(2) "Intangible property" means patents, trade names, trademarks, service marks, copyrights, and similar intangible assets.

(3) "Interest expenses and costs" means amounts directly or indirectly allowed as deductions under Section 163 of the Internal Revenue Code for purposes of determining taxable income under the Internal Revenue Code, to the extent the expenses and costs directly or indirectly are for, relate to, or are in connection with the direct or indirect use, maintenance, or management of intangible property.

(4) "Related entity" means any of the following:

(A) A person or an entity that directly or indirectly owns more than fifty percent (50%) of the value of the outstanding stock, capital, or assets of the taxpayer.

(B) An entity in which the taxpayer directly or indirectly owns more than fifty percent (50%) of the value of the outstanding stock, capital, or assets.

(b) The attribution rules of Section 318 of the Internal Revenue Code apply for the purpose of determining ownership for the purposes of this section.

(c) Except as provided in subsection (d), for purposes of computing adjusted gross income under IC 6-3-1-3.5, a corporation shall add to its federal taxable income any amount deducted in the calculation of its federal taxable income for:

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1 (1) interest expenses and costs; and  
 2 (2) intangible expenses and costs;  
 3 directly or indirectly paid, accrued, or incurred to or in connection  
 4 with transactions with one (1) or more related entities for the  
 5 taxable year. To prevent the double taxation of the same income of  
 6 different taxpayers, any amount added to the federal taxable  
 7 income of the corporation under this section shall be subtracted  
 8 from the federal taxable income of the related entity that received  
 9 the amount for purposes of determining the adjusted gross income  
 10 of the related entity under IC 6-3-1-3.5.

11 (d) The adjustments required under subsection (c) do not apply  
 12 to interest expenses and costs and intangible expenses and costs  
 13 that meet any of the following conditions:

14 (1) The related entity during the same income year directly or  
 15 indirectly paid, received, accrued, or incurred the expenses or  
 16 costs to or from a person that is not a related entity.

17 (2) The amount received by the related entity is subject to  
 18 income tax or a tax similar in operation to the tax levied  
 19 under this article in:

20 (A) Indiana or another state; or

21 (B) a foreign nation that has a tax treaty with the United  
 22 States.

23 (3) The transaction giving rise to the interest expenses and  
 24 costs or the intangible expenses and costs between the  
 25 corporation and the related entity did not have as its primary  
 26 purpose the avoidance of the tax due under this article. For  
 27 purposes of this subsection, the existence of both the condition  
 28 described in clause (A) and at least two (2) of the conditions  
 29 described in clause (B) is sufficient to establish a conclusive  
 30 presumption that the transaction did not have as its primary  
 31 purpose the avoidance of tax:

32 (A) The intangible expenses and costs or interest expenses  
 33 and costs are within a range that would be paid by parties  
 34 acting at arm's length, as determined by an independent  
 35 appraisal or other evidence.

36 (B) Any two (2) of the following with respect to a related  
 37 entity:

38 (i) The corporation has no right of use or ownership of  
 39 the intangible property except those rights granted by  
 40 the related entity.

41 (ii) The related entity is engaged in a profit-making  
 42 business.

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(iii) Net income from the intangible expenses and costs or interest expenses and costs is retained and invested by the related entity for the benefit of the stockholders of the related entity.

(iv) Expenses of maintaining, managing, and defending the property of the related entity are paid for by the related entity, and if the services are provided by the corporation, the related entity pays for the services at an arm's length rate, as determined by an independent appraisal or other evidence.

(v) The related entity holds separate board meetings, maintains separate assets, executes separate contracts, maintains separate offices, and has employees separate from the corporation.

(e) Notwithstanding IC 6-8.1-5-1 or any other law, with respect to any dispute regarding the amount that must be added to the taxable income of a taxpayer in accordance with this section, this section shall be strictly construed against the department in favor of the taxpayer, and the department has the burden of proof with respect to any issue relevant to ascertaining the liability of a taxpayer under this section only if:

(1) the taxpayer has produced evidence that establishes that there is a reasonable dispute with respect to the issue; and

(2) the taxpayer has adequate records of its transactions and provides the department reasonable access to the records.

SECTION 3. IC 6-8.1-5-1 IS AMENDED TO READ AS FOLLOWS [EFFECTIVE JANUARY 1, 2005 (RETROACTIVE)]:

Sec. 1. (a) If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to IC 6-8.1-10 concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail.

(b) If the person has a surety bond guaranteeing payment of the tax for which the proposed assessment is made, the department shall furnish a copy of the proposed assessment to the surety. The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. **Except as provided in IC 6-3-2-20,** the burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.

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(c) The notice shall state that the person has sixty (60) days from the date the notice is mailed to pay the assessment or to file a written protest. If the person files a protest and requires a hearing on the protest, the department shall:

(1) set the hearing at the department's earliest convenient time; and

(2) notify the person by United States mail of the time, date, and location of the hearing.

(d) The department may hold the hearing at the location of its choice within Indiana if that location complies with IC 6-8.1-3-8.5.

(e) No later than sixty (60) days after conducting a hearing on a protest, or after making a decision on a protest when no hearing is requested, the department shall issue a letter of findings and shall send a copy of the letter through the United States mail to the person who filed the protest and to the person's surety, if the surety was notified of the proposed assessment under subsection (a). The department may continue the hearing until a later date if the taxpayer presents additional information at the hearing or the taxpayer requests an opportunity to present additional information after the hearing.

(f) A person that disagrees with a decision in a letter of finding may request a rehearing not more than thirty (30) days after the date on which the letter of finding is issued by the department. The department shall consider the request and may grant the rehearing if the department reasonably believes that a rehearing would be in the best interests of the taxpayer and the state.

(g) If a person disagrees with a decision in a letter of finding, the person may appeal the decision to the tax court. However, the tax court does not have jurisdiction to hear an appeal that is filed more than one hundred eighty (180) days after the date on which the letter of finding is issued by the department.

(h) The tax court shall hear an appeal under subsection (g) de novo and without a jury. The tax court may do the following:

(1) Uphold or deny any part of the assessment that is appealed.

(2) Assess the court costs in a manner that the court believes to be equitable.

(3) Enjoin the collection of a listed tax under IC 33-26-6-2.

(i) The department shall demand payment, as provided in IC 6-8.1-8-2(a), of any part of the proposed tax assessment, interest, and penalties that it finds owing because:

(1) the person failed to properly respond within the sixty (60) day period;

(2) the person requested a hearing but failed to appear at that

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1 hearing; or  
 2 (3) after consideration of the evidence presented in the protest or  
 3 hearing, the department finds that the person still owes tax.  
 4 (j) The department shall make the demand for payment in the  
 5 manner provided in IC 6-8.1-8-2.  
 6 (k) Subsection (a) does not apply to a motor carrier fuel tax return.  
 7 SECTION 4. [EFFECTIVE JANUARY 1, 2005 (RETROACTIVE)]  
 8 **(a) The definitions in IC 6-3 apply to this SECTION.**  
 9 **(b) IC 6-3-1-3.5 and IC 6-8.1-5-1, both as amended by this act,**  
 10 **and IC 6-3-2-20, as added by this act, apply to the computation of**  
 11 **adjusted gross income only for a taxable year beginning after**  
 12 **December 31, 2004.**  
 13 SECTION 5. **An emergency is declared for this act.**

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